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July 30, DJIA 808.60; PTI 1267; A-D Ratio –27.89
Aug. 6, DJIA 784.34; PTI 1247; A-D Ratio –28.50

TECHNICAL APPRAISAL: With a blizzard of economic news events enveloping us daily via newspapers, TV and radio, we are apt to forget that markets don't move on news, markets move AHEAD of the news. "News known," runs the old adage, "is news discounted".

Last week my measurements of selling pressure on the NYSE rose to new highs. Since by definition, a bottom is "an area wherein the desire to sell has been satisfied," the new highs in selling pressure hardly coincided with the widely-advertised "major bottom." Following the August 2 celebration rally (based on the discount rate cut), the market turned down. By August 4 the Dow Averages were below their late-July lows while the major composite averages were making new bear market lows.

Over the past few weeks we have witnessed a highly significant progression of technical events. I list some of them as follows:

July 28: The D-J Utility Average broke below its 103.61 low for 1982 to a new low for the year. The Utility Average (since it is sensitive to interest rates, financing and power usage) tends to be a Wall Street bellwether. New lows in the Utility Average are therefore considered bearish for the general market.

July 29: Primary Trend Index broke to a new low for the bear market at 1271. This was another obvious indication of technical deterioration. The PTI measures the build-up (or decline) in the overall technical condition of the market.

July 29: The *A-D ratio* (which is a proxy for the entire NYSE) broke to a new bear market low. The move tells us that the majority of stocks are continuing to slide into the loss column. The simultaneous new lows in the PTI and the A-D ratio should act as an anchor, dragging the market down with them.

July 29: The *negative volume index* broke to a new low. This index is the differential in the daily A-D figures–but only on days when volume is below that of the preceding day. The Neg. volume index monitors the movement of informed (investment) money. When informed money leaves Wall Street the implications are decidedly bearish.

July 29: The *cumulative most-active stock index* (CMAS) broke to a new 1982 low. This index has been a powerhouse for years. The fact it is finally breaking down has obviously bearish connotations.

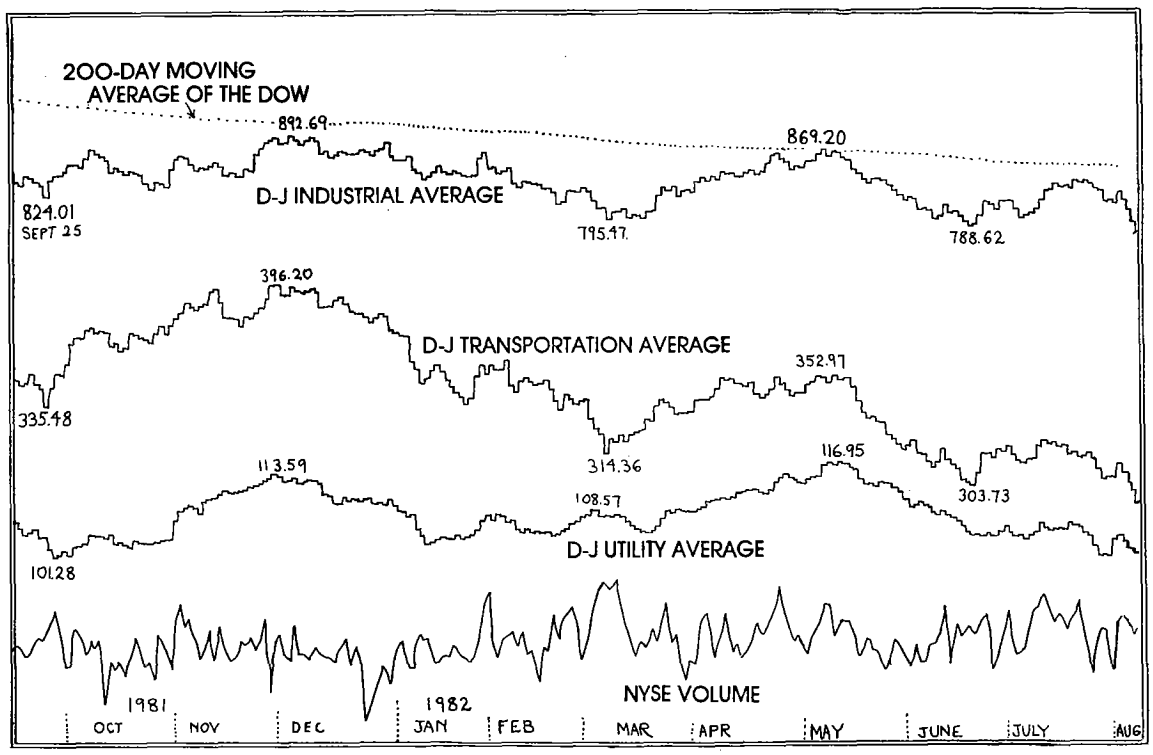
July 30: The NYSE Index sank to a new 1982 low, as did the S & P 500. This action was confirmed by a new 1982 low in the Wilshire 5000 (the Wilshire includes all NYSE stocks, all Amex stocks and many leading O-T-C issues).

Aug. 4: With the Dow down 12.93, broad weakness was seen as new lows were recorded again by the Wilshire 5000, the

FRONT PAGE COMMENT: In the last Letter I wrote that in my opinion the resignation of Murray Weidenbaum along with the President's endorsement of the new tax bill represents a "coming apart at the seams" for the Reagan administration. The tax bill is now stirring up more antagonism within the Republican ranks than anything seen in years–it is threatening to split the conservative Republicans from the Reagan fold. In fact, I would say that with his endorsement of this "tax turkey," Reagan has lost the support of the Republicans who were responsible for his nomination and election.

How bad is the new tax bill? Most of it represents an attack on business, but it also attacks professional pension plans, it will withhold income on interest and dividends and it "nickel and dimes" the public via gas and cigarette taxes. According to Human Events magazine, the new bill would cost taxpayers $227 billion through 1987!

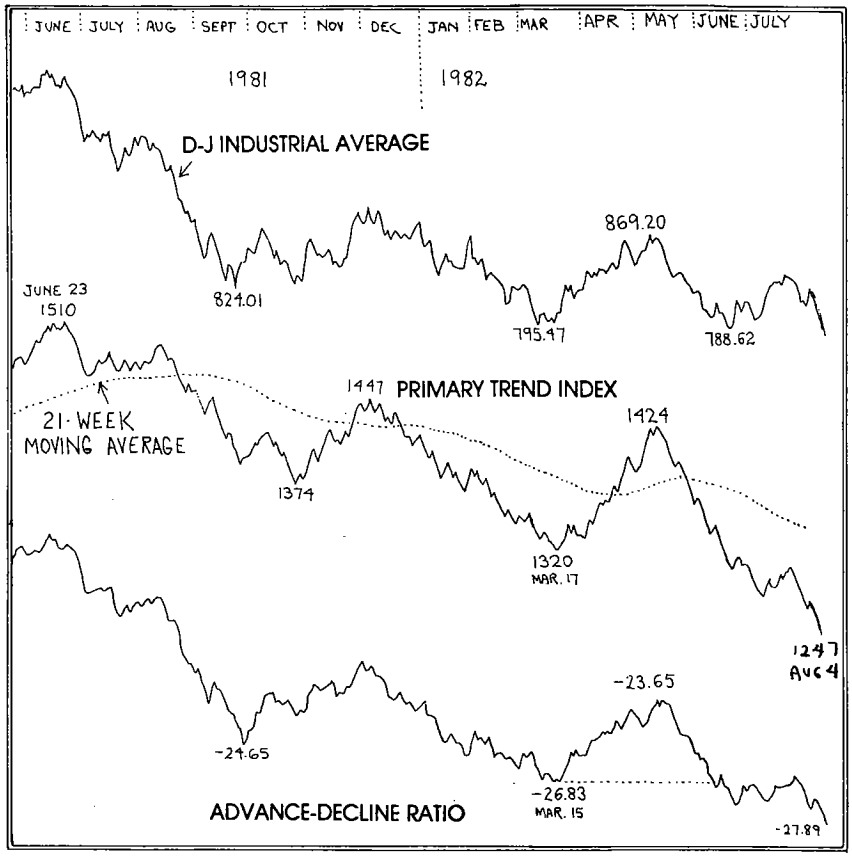
Worst of all, the new bill represents an 180 degree turn, a total reversal of all the concepts Reagan originally put forth. In effect, the bill is a capitulation to tax boosting rather than cuts in spending. Conservative Republicans want no part of it. Democrats are laughing up their sleeves. And Reagan (in evident confusion) endorses the tax bill!



S & P 500, and the NYSE index. New lows also seen in the negative volume index (which is now crashing), the cummulative most-active index and the Dow A-D (this is the breadth index for the D-J 30 Industrials).

Aug. 5: The major composite averages broke to new bear market lows, while the D-J Transportation Average fell below its June low of 303.72.

Aug. 6: The D-J Industrial Average tumbled to a new low below 788.62, confirming the Transports and re-confirming the primary bear trend. The A-D dropped (incredibly) for the 10th time in 11 sessions.



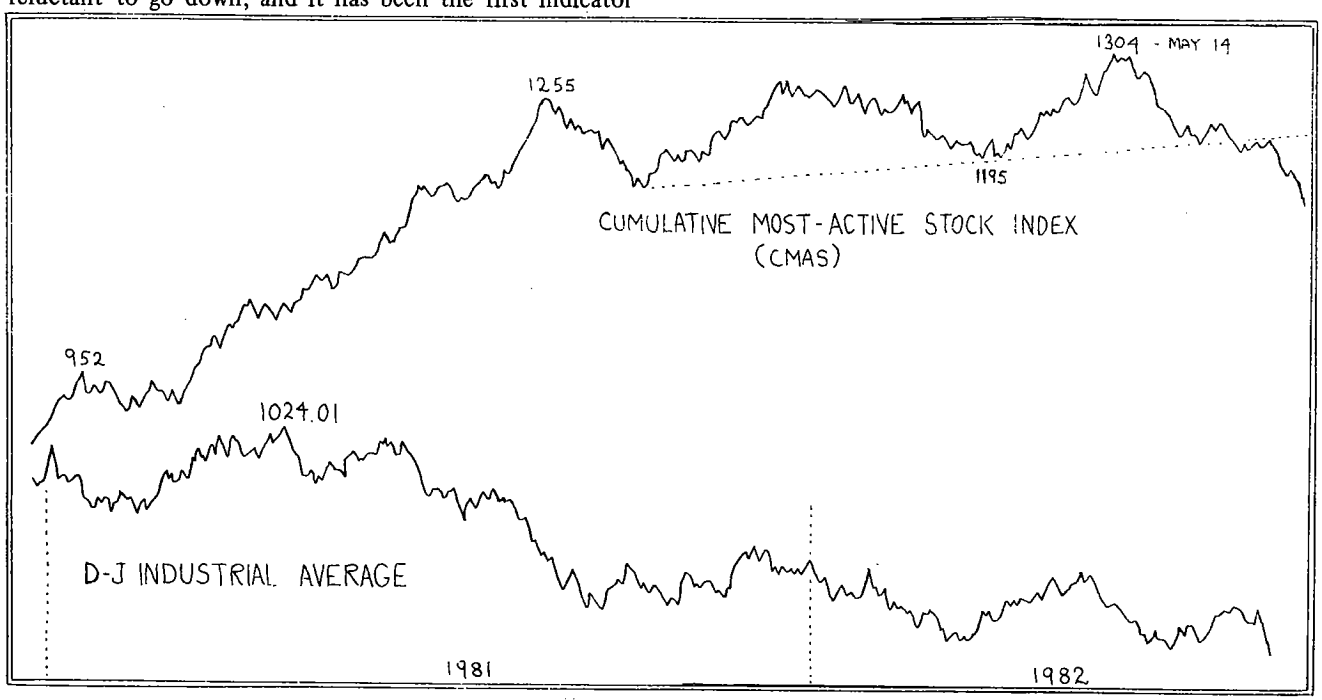
PERSISTENCE: A rule I have used over the years is this: "Watch for *persistence* of movement. When the most persistently bullish average or index finally turns down, that is often a major bearish sign. Conversely, when the most persistently bearish average or index finally turns up, that usually is a very bullish sign".

The most persistently bullish indicator since 1974 has been the cummulative most-active stock index. This index is the differential in the 15-most active stocks (listed daily) plotted as a daily cummulative total. In other words, if on a given day 12 of the most-actives on the NYSE were higher and 2 were lower and 1 was unchanged, I would add a plus 10 to the previous day's running total.

On any given day, the 15 most active stocks on the NYSE comprise from roughly 12% to 15% of total NYSE volume. A great deal of professional activity tends to be concentrated in the 15 most active stocks, and in general I would say that the most-actives tend to lead the market (in direction). Therefore, I follow the trend of the most actives with interest. How do I determine the trend of the 15 most actives? Simply by tabulating the advancing or declining action of the plurality of the 15. I call this daily plurality (each day added to the last day's plurality) the cummulative most-active index (CMAS).

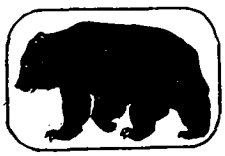
The CMAS has been a tiger on the upside ever since 1974. It has been reluctant to go down, and it has been the first indicator to turn up. The accompanying chart shows the daily action of CMAS from 1981 to the present along with the Dow as a comparison.

Note that although the Dow topped out on April 27, 1981 at 1024.01, the CMAS continued to climb—and climb strongly. In August, even though the Dow was sliding, the CMAS hit a peak of 1255. The CMAS declined into September, then turned up again. The trend through most of 1982 was up for CMAS. On May 14, 1982 the CMAS recorded a new high of 1304, well above the 1981 high. But since then the CMAS has turned weak. Two weeks ago the CMAS broke a 10-month



rising trend. The index now looks exceedingly toppy (bearish). On July 29 the CMAS broke below its March low of 1195, and for the first time in years I have graded the CMAS bearish.

INVESTMENT POSITION: I follow most of the leading investment advisory letters. They've been trading, they've been jockeying for positions, and they've been loading up with stocks



in what they have stated (all during June and July) to be "a major base for a new bull market." Already, this eager and aggressive policy has cost their subscribers a bundle. Remember, three consecutive trades with a loss of 10% on each–represents a loss of one-third of your capital.

My approach has been based on orthodox Dow Theory. A bear market was signalled on July 2, 1981, and nothing I've seen since then tells me that the bottom has arrived. I've stuck to a safe policy of investing in T-bills or money market funds which concentrate in government securities. So far, none of my subscribers have lost money, none have been whip-sawed, none have lost sleep wondering "if the bottom is really here."

This is a tough and competitive business, and I can understand the eagerness and anxiety with which many advisors have sought to get in at the bottom. But as the old saying goes, "The graveyards of Wall Street are strewn with the bones of MEN WHO HAVE BEEN RIGHT TOO SOON."

PRIMARY TREND: It's a paradox, but the simpler and more universal a concept, the more difficulty men have in understanding that concept. I have always found this to be true as far as the concept of the primary trend is concerned.

The primary trend is the great, underlying force which moves the markets. It is an axiom of Dow Theory that the primary trend is immutable; it cannot be changed, reversed or manipulated. Like the tide of the ocean, the primary trend runs to completion.

A study of history reveals that there have been three great revolutionary ideas, each of which has shaken man's vision of himself. Each of these ideas have met with universal protest, anguish and even violence. After all, is not man the center of his own world? Is not man master of his own fate? The three concepts are (1) The sun is the center of the solar system, not the earth–Capernicus. (2) Man evolved from a lower state of animal life-Darwin, (3) Man is subject to forces within himself which he is not master of–his unconscious–Freud. Many people today will argue the truth of the second, others still disbelieve the third.

Perhaps we should add a fourth ego-shrinking concept: The primary trend of the market is more powerful than any man or group of men. The primary trend is greater than the President or Congress; it is more powerful than all the treasuries of the world combined.

According to Dow's Theory, the primary trend was signalled as down on July 2, 1981. That primary bear signal was discussed at length in these Letters. I have every reason to believe that the July 2 signal was a valid one. The signal was a forecast of contradiction in the economy and lower stock prices–for an indeterminate period of time. Dow's Theory tells us direction–it does not tell us extent.

The only question for Dow Theorists at this time (the only big question) is "How long will this bear market last and how far will it carry?" To answer that question I apply every faculty I have at my command–my experience, my knowledge, my statistics, my intuition.

I realize that there are many advisories and publications that have recently turned bullish. Indeed, a certain number of leading advisories have now announced that the bear market is dead, and that "a new bull market is born." They note the market rally since mid-June, they note the various improving sentiment indicators, they note favorable put-call ratios, better high-low figures, record short interest levels, and so forth.

I look at the market somewhat differently. To me, the market is a living thing, a breathing, scheming monster that heads in one direction (say a bull market) and holds to that direction until he is exhausted. Then the monster starts down the ladder and despite protestations (which may cause him to climb a rung or two at selected intervals) the monster continues down the ladder until he can descend no more. At that point the bear market ends.

People who don't understand the concept of the primary trend are continually looking for things or events that will "turn the tide." If Congress would only pass this law, if the President would do this, if debt could just be reduced, if GM would only make a better car.

Or the wishers watch for magic events. The bond market is stronger, the leading indicators are rising, the inventory/sales ratio is improving. But sad to say, these events don't turn a bear into a bull. Bear markets continue down until the worst that can be seen ahead is fully discounted in the price structure. Bear markets end amid pessimism and gloom (and exhaustion of selling) they don't end with a Presidential flourish of a pen.

With all this in mind, the question I ask myself is, "Has the market discounted the worst? Have all the potential horrors been fully discounted in the price structure of the market? Or to put it another way, has a 15 month decline in the Dow, a decline which wiped out 22% of its value, been sufficient to discount the worst that lies ahead? The answer to this is that I do not know for sure, but I doubt it".

Question: Russell, I thought it was important to monitor the various sentiment indicators as the market moves along. Why don't you give more signifigance to the short interest, the put-call ratio, etc.?

Answer: I attach great significance to these indicators during a bull market. When the trend is up, mass pessimism simply means that the market is sold out, too many people have refused to believe in the primary bull trend. But during a bear market I expect pessimism. After all, during a bear market most people are losing their shirts. Do you think there wasn't pessimism during 1930, 1931 and early 1932? Do you remember pessimism during 1973 and '74? Bear markets always foment pessimism. But there are a lot more items than pessimism that I must measure before I can be convinced that a bear market is over.

Question: I notice that you are putting a good deal of emphasis on the *action* of the market indicators rather than the sentiment indicators. Why?

Answer: One reason is that I feel that the sentiment indicators are currently "in", very fashionable. On the other hand, analysts are less interested in market action. My PTI is entirely based

on various measurements of market action, and I have been putting great emphasis on the PTI. As long as the PTI is weak (and it has been weak), I feel that the market is basically the wrong place to be.

Question: I see you still place priority on reading the Averages? Isn't this a bit old-fashioned?

Answer: To my mind, the most reliable market studies have to do with the averages and the A-D ratio. If I could have only three market tools, I would choose the D-J Industrials, the D-J Transports, and the A-D ratio. If I could have three more I would add volume, the D-J Utility Average, and the Bond Index.

In reading the averages I have found that an intimate knowledge of divergences and non-confirmations is necessary. In a healthy movement, the averages tend to move (along with the A-D ratio) as if "locked together." When a movement is marred by divergence or non-confirmation, it is usually (but not always) a sign of distribution and an impending reversal of the trend.

The study of volume is very complex. For instance, few students realize that most major declines begin on low volume. A high volume (sudden) drop is characteristic of a reaction in an overbought bull market. A drifting, low volume decline, a decline which picks up volume as it goes along, is characteristic of a bear market.

Question: Russell, in a recent Letter you stated that you thought the second (psychological) phase of this bear market was ending and that the third phase lay directly ahead. Yet I note that the public is still reasonably optimistic. They're spending freely, retail sales are holding. Do you still think the third phase lies directly ahead? What do you think will finally shake the public?

Answer: On August 6 the D-J Industrials and Transports broke to new bear market lows. This was confirmed by new lows in the major composite averages, the A-D ratio and the PTI. I would say that we are now in the early stages of the third phase of the bear market. How long the third phase will last is anyone's guess. It could be 6 months, it could be 6 years. There is NO WAY of predicting its length or extent at this time.

What will finally panic the public? Here's my guess, and it's only a guess. I would say that MAJOR trouble in the banking system will ultimately panic the public, and the result will be a frightening run on the money market funds (whose assets are now rising in an exponential curve similar to the gold rise during 1979-80). If I had to guess regarding how a bank fiasco could start, I would say that it will start in the Eurodollar market (where there is no lender of last resort).

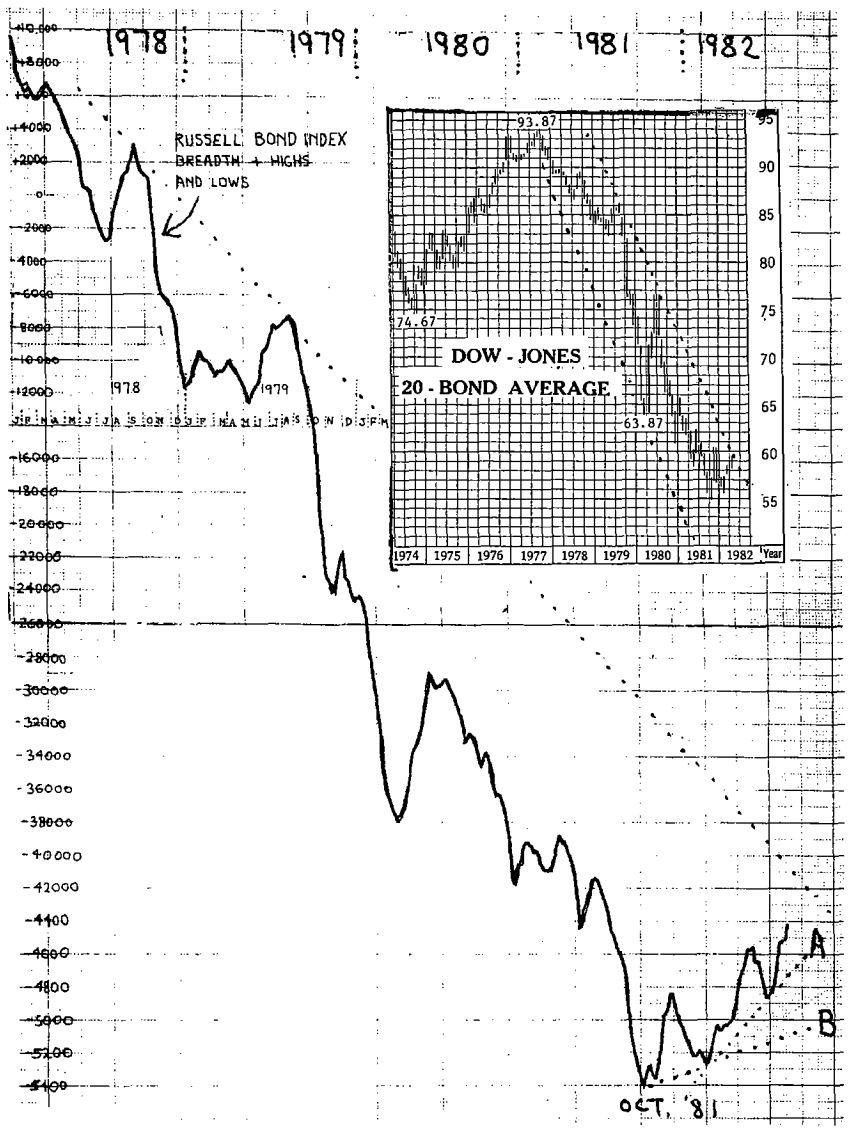
BONDS: Has a new bull market in bonds started? My immediate response, based on what I see of government debts and financing, is "No, I don't see how anything happening today can be conductive to a new bull market in bonds." But that's just a subjective opinion, and I'd rather look at the technical data.

The large chart shows the Russell Bond Index, based on daily advances and declines (plus daily new highs and lows) on the NYSE listed bonds. What we see here (starting in 1978) is the most vicious bond bear market in US history, a bond collapse that cut the price of the majority of US bonds from 1/3 to 1/2. This kind of a panic is seldom seen in any market. When it is seen in a market as large as the US debt market, it constitutes a financial disaster of the first magnitude.

The recent low on the Russell Bond Index was scored in October of 1981. From that low the Index has climbed higher in a series of five short legs (three up and two down). The last leg (upward) is still in progress.

The fact is that there's no need for guessing from here on. The secondary trend for bonds can be considered to be up as long as the little trendline marked A on the chart is respected. Trendline B is more important, and a breaking of both trendline A and B would abort the move since the October lows. Until then, the bond action is constructive—and intermediate-term bullish.

To place the picture in greater perspective, I have included the monthly chart of the widely-followed D-J 20-Bond Average. So far, the 1981-82 rally is far smaller than the 1980 rally—but it could be that a better base is being built.



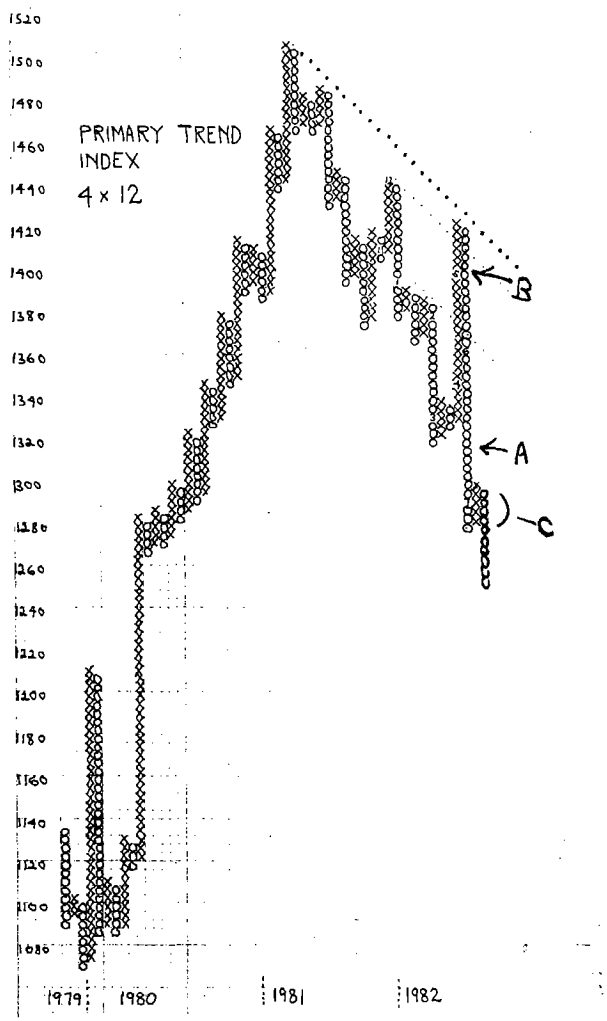
ADVICE: Positions of up to 25% in 5-10 year Treasury notes are warranted, but I'm not excited yet. As you can see from both of these charts, if a real primary bull market in bonds is starting, its got a LONG way to go (so far the bond rally is just a blip on the charts).

Note: Despite the recent easing in US interest rates, the major foreign currencies have been collapsing right up to the time of this writing. Why? One reason is that they may see US interest rates going higher over coming months, and of course rising US rates mean that foreign currency holders will dump their own currencies in order to move into high yielding US dollars.

At any rate, the strength of the dollar continues unabated. I might add that in terms of most foreign currencies, gold now looks very strong.

SPECIAL STUDY: Subscribers who have been with me for a few years or more know that the PTI is an indicator to be taken seriously. Remember my rule: "You don't have to follow the PTI, but never, never position yourself against it." The PTI has done an excellent job of signalling this bear market, and it has done an equally fine job since then of keeping us OUT of the bear market.

This point & figure chart shows us all the action in the PTI since 1979. As you can see, we had a strong run-up earlier in the year, and the run-up was followed by an equally severe drop. When the PTI broke below its March low at 1320 (A on chart), it left a very bearish "tail" (B on chart) towering above it. This tail is a technical trap, a "lock-in" of the bulls.



A consolidation occurred at C, and last week the PTI broke down again, falling out of its consolidation pattern. From the C area, the PTI should fall at least another 140 points. This could take it down towards its 1979-80 base.

NOTES & QUOTES: Senator Jack Kemp is spearheading the conservative Republican drive to dump the nutty new tax bill. If the bill is killed, the deficit will rise about $20 billion next year. If the bill goes through, it will be a wack on the head for business (almost all the tax gains for business put through last year will be taken back). Thus, the market and the economy face a perfect Catch-22.

I've been saying for years that this was coming. It's the basis for the bear market. The deficit has hit the fan, and the economy has hit a brick wall. What's the answer? The answer is massive cuts in entitlements, and big cuts in military spending. The horror that no politician has wanted to face has arrived–spending MUST BE CUT AND CUT IN A BIG WAY.

But the boys are NOT yet serious, they're not dealing with the problem yet. As witness their reluctance to keep the cost of living increase for Fed employees to 4%. Me, I'd allow no more increases. Dream on boys, dream on. The markets are telling the story now, not Washington.

* *

The Social Security System, for the first time, will have to borrow–up to $7 billion according to Commissioner John Svahn. "It goes downhill from here," he said in a speech two weeks ago. Svahn said that in its present form, SS will, by the year 2010, have to take 25% of the US payroll to keep up its current payouts. As things stand now, said Svahn, SS can make it through to July 3, 1983. Then it will run out of money. Russell conclusion: SS was originally conceived as a basic subsistence payout, a guaranteed minimum safety net–rather than a major income provider with which one could retire in comfort. SS is going to have to go back to the old concept.

If I had my way SS would apply only to total incompetents, mentally disordered and basket cases. It would be financed by all Americans but at a very low rate. The great bulk of the population would have IRAs or pension plans with very high asset building capabilities. No pension plan or SS concept is worth a damn if it is not FUNDED. Social Security is not funded–thus it's basically a chain-letter vehicle that must and will break down.

* *

Dome Mines of Canada (gold, oil, metals) was always considered the ultimate inflation hedge. From its high (NYSE) of 33½, the stock has dropped to a recent low of 5. One problem is that Dome owns 30% of Dome Petroleum. Dome Petroleum could be Canada's largest bankruptcy, if it is not bailed out by the Canadian government (which is running a $20 billion record deficit of its own). DMP must pay four Canadian banks $1.03 billion by September 30. Dome has just ordered a 10% cut in all salaries (a drop in the bucket) and is trying desperately to sell off some of its assets (with little success). The Canadian government insists it will not come to Dome's aid. If nobody does, we could have the oil bust of the decade.

* *

To an ex-New Yorker (and I've been away 21 years) there's a secret yearning–and it's to get morning delivery of his beloved

New York Times (which is the nation's greatest newspaper, assuming you skip the superliberal and often dopey editorials). In two weeks the Times (via satelite and a receiving dish half the size of a football field) will be printed in Torrance, California. But I jumped the gun and ordered the daily Times (which is still flown in from NYC) Last Sunday, as I left the house at 5AM to jog, I tripped over a heavy object. I looked down and saw that I had stumbled over that fat little bundle, the New York Times, Sunday edition. A broad smile covered my face. My heart leapt. The Sunday Times on Sunday morning–5AM! Some people love big cars, some people love fast boats, I love newspapers! The millenium has arrived.

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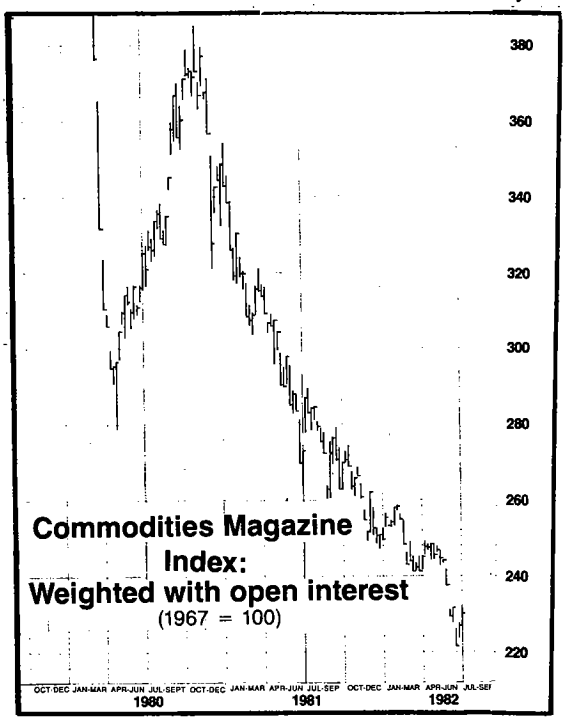
Stocks aren't the only items caught in a major bear market. This is one of the best and broadest of the commodity indices.



LATE NOTES: The week ending August 6 wound up in a route. All markets with the exception of precious metals "fell out of bed." The Dow broke decisively under its June low of 788.62, thereby confirming the new low in the Transports. Under Dow Theory, the primary bear market is thereby reconfirmed–the bear continues to hold the nation and Wall Street in its grip. The prediction–hard times ahead.

The new lows in the D-J Averages were confirmed all around by new lows in the NYSE Index, the S&P 500, the Wilshire, the A-D Ratio, the negative volume index, the cumulative most-active index and the Dow A-D. Big liquidating volume has not yet been seen. But since this is the third phase of the bear market, I would think that we should see big downside volume somewhere along the line.

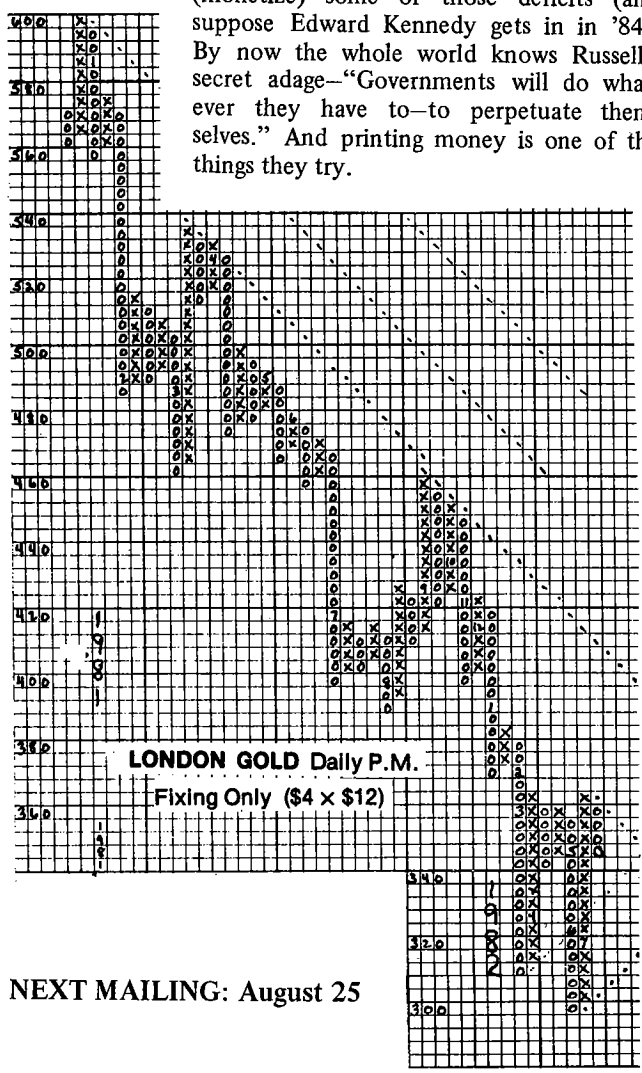
My 233-day cycle is now in its bear phase. The cycle peaked perfectly on schedule–namely in the first week in August give or take a week. The bear segment of this cycle carries through to October. The bear segment should see a massive oversold situation in the market with perhaps a major bottom between now and October (although I don't like to guess about such things).

Our policy of staying with short-term government obligations is now paying big dividends. I'm now receiving letters from readers thanking me for keeping them out of a disaster. Don't thank me, thank the Dow Theory and the PTI. I don't make the markets, I just follow them, but when markets go down the way this one has been going, I like to see my subscribers OUT. It's been a tough year, but we're survivors and we're ahead of the game. I want to wish the best to all my loyal and faithful subscribers. Chins up.

GOLD: Not too much action in gold since the last Letter. The 5-week moving average (MA) for gold is 342, and this is bullishly 5 points above the 13-week MA which stands at 337. The more important 50-week MA is at 373, and when the 13-week MA crosses above the 50-week MA we will receive a true bull signal. The 13-week rate of change for gold is 100, all right but not thrilling.

The point & figure chart for gold (chart courtesy Chartcraft, Larchmont, NY) shows gold in a bullish trend with a vertical upside "count" of 492 (based on the initial thrust). A price of 368 (London) would break gold out (again) on upside and would constitute a very bullish event. But until then, the waters look calm. I continue to believe that we have seen the low for gold.

Gold fundamentals? Why could gold be bullish? Two opposing reasons: first, with a potential crisis in the world monetary system, people turn to real money as an insurance policy. Gold is real money. Second, with unbearable deficits facing the US over coming years, politicians will be tempted to "print" (monetize) some of those deficits (and suppose Edward Kennedy gets in in '84). By now the whole world knows Russell's secret adage–"Governments will do whatever they have to–to perpetuate themselves." And printing money is one of the things they try.



NEXT MAILING: August 25